In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 574

JULIUS GARFINCKEL & CO., INCORPORATED (SUCCESSOR TO BROOKS BROTHERS, INC., FORMERLY THE A. DEPINNA COMPANY), PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Prior to February 6, 1952, taxpayer Julius Garfinckel & Company, Incorporated, owned 100% of the common stock of Brooks Brothers, a corporation engaged in the manufacturing and retail sale of men's wear, and 58% of the common stock of the A. DePinna Company, a corporation engaged in the sale of both men's and women's clothing at retail. On February 6, 1952, Garfinckel caused Brooks Brothers to be consolidated into DePinna pursuant to Section 86 of the New York Stock Corporation Law (McKinney's Consolidated Laws of New York Annotated, Vol. 58), and the name of the continuing DePinna corporation was changed to Brooks Brothers. Under the terms

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of the merger, Garfinckel wound up with 95% of the stock of the surviving corporation. Subsequent to the consolidation, the businesses previously carried on by DePinna and Brooks Brothers were operated as separate divisions of the consolidated corporation with separate records (Pet. A2–A4).

Net operating losses had been sustained by DePinna prior to the consolidation, and the DePinna division of the consolidated corporation continued to lose money thereafter. Brooks Brothers, on the other hand, had been a profitable enterprise prior to the consolidation and the Brooks Brothers division continued to make money after the consolidation. The question in this case is whether the pre-merger losses of the DePinna business (retail sale of men's and women's clothing) may be used to offset the post-merger income generated by the Brooks Brothers business (manufacture and retail sale of men's wear) under the net operating loss carryover provision, Section 122(b)(2)(B) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed., Sec. 122). The action of the Commissioner of Internal Revenue in disallowing the claimed carryover for the year ending July 31, 1953, was sustained by the Tax Court, which was, in turn, affirmed by the Court of Appeals. As viewed by both courts below, the claimed income tax deduction was barred by the "continuity of business enterprise" rule enunciated by this Court in *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382 (Pet. A2–A4, A10).

The decision below was correct. There is no conflict of decisions nor any other reason warranting further review by this Court.

1. The rule prescribed in *Libson Shops, Inc.* v. *Koehler, supra,* is that a taxpayer may not carry forward the net operating losses of one business to offset income generated by another business. The "continuity of business enterprise" test is a definitive statement of the purposes which Congress intended to be served by the carryover provisions, and it has been applied by the federal appellate courts to a broad range of fact situations. Whatever its scope, however the *Libson Shops* decision is clearly dispositive of the case at bar.

In *Libson Shops,* sixteen corporations operating retail stores selling women's apparel were merged into a seventeenth corporation which had been providing management services for the sales corporations. All of the corporations were owned by the same individuals whose proportionate ownership interests were the same before and after the merger. Three of the sales constituents incurred operating losses before and after the merger. The surviving corporation attempted to carry forward the pre-merger losses to offset income of the post-merger consolidated enterprise. Holding that the surviving corporation was not the same "taxpayer" (within the meaning of Section 122(b) of the 1939 Code) as its pre-merger constituents, this Court declared that the purpose of the carryover provisions was not to give a merged taxpayer tax advantages over others who did not merge, concluding with the statement that (p. 390) "petitioner is not entitled to a carry-over since the income against which the offset is claimed was not produced

by substantially the same businesses which incurred the losses."

Similarly, in the instant case, taxpayer, the complete owner of a profitable corporation which operated retail stores and engaged in the manufacturing of clothing, caused it to be merged into another corporation in which taxpayer owned a controlling interest. The second corporation, which had been running at a loss, was engaged solely in the operation of retail stores not connected with the profit corporation. After the merger, the two businesses were operated as separate divisions; the loss enterprise continued to produce losses and the profit enterprise continued to generate income. The question here is whether the pre-merger losses of the loss enterprise may be carried forward to offset income of the consolidated corporation attributable solely to the profit enterprise.

As both courts below correctly held, allowance of the claimed net operating loss carryover is barred by the rule in *Libson Shops*. It is immaterial—a mere technical maneuver—that the loss corporation was chosen to be the surviving corporation. Neither the tenor nor the terms of the *Libson Shops* opinion permit anything to turn on this happenstance, as the federal appellate courts applying *Libson Shops* consistently have stated. Accord: *Federal Cement Tile Co.* v. *Commissioner,* (C.A. 7th), decided October 23, 1964 (64-2 U.S.T.C., par. 9803); *Norden-Ketay Corp* v. *Commissioner,* 319 F. 2d 902 (C.A. 2d), certiorari denied, 375 U.S. 953; *Mill Ridge Coal Co.* v. *Patterson,* 264 F. 2d 713 (C.A. 5th), certiorari denied, 361 U.S. 816; *Willingham* v. *United States,* 289 F. 2d 283

(C.A. 5th), certiorari denied, 368 U.S. 828; *Commissioner* v. *Virginia Metal Products, Inc.*, 290 F. 2d 675 (C.A. 3d), certiorari denied, 368 U.S. 889; *J. G. Dudley Co.* v. *Commissioner*, 298 F. 2d 750 (C.A. 4th); *Huyler's* v. *Commissioner*, 327 F. 2d 767 (C.A. 7th).

2. Taxpayer asserts that the court of appeals misconstrued the *Libson Shops* opinion, failing to recognize that the question in loss carryover cases is whether the "taxpayer" who sustained the losses is the same as the "taxpayer" who will reap the benefit of the loss carryover (Pet. 5–7). As pointed out by the court below (Pet. A6–A8), however, this is a misleading over-simplification of the issue. Although the same jural entity may be involved, the dispositive question is whether, in practical, economic terms, the business which produced the losses is the same business which generates the income sought to be offset by the carryover. This Court, in characterizing the alternative argument of the Government which it ultimately accepted, stated (*Libson Shops*, p. 386):

> It argues that the prior year's loss can be offset against the current year's income only to the extent that this income is derived from the operation of substantially the same business which produced the loss. Only to that extent is the same "taxpayer" involved.

Contrary to the position of taxpayer, the *Libson Shops* rationale was not misconstrued by the court of appeals, nor, for that matter, has it been misconstrued or even regarded as difficult to understand by any other federal appellate court. See, particularly, the so-called "single corporation" cases in which the loss

corporation admittedly was the same jural entity which sustained the loss but the carryover privilege was regarded, under *Libson Shops,* as barred. *J. G. Dudley Co.* v. *Commissioner, supra; Commissioner* v. *Virginia Metal Products, Inc., supra; Mill Ridge Coal Co.* v. *Patterson, supra; Huyler's* v. *Commissioner, supra; Norden-Ketay Corp.* v. *Commissioner, supra.*

3. The question involved in this case is of diminishing importance in the administration of the loss carryover provisions. Loss carryovers following tax-free organizations are specifically limited under the 1954 Code. See, e.g., Sections 381 and 382(b) (26 U.S.C., 1958 ed., Secs. 381 and 382). See, also, Rev. Rul. 58–603, 1958–2 Cum. Bull. 147, and Rev. Rul. 59–395, 1959–2 Cum. Bull. 475, 480. If, as taxpayer suggests, this Court should agree to review a loss carryover case for the purpose of resolving all of the unanswered questions as to the scope of *Libson Shops* in fact situations which have not yet arisen in the litigated cases, this case—which involves the Internal Revenue Code of 1939—would be a peculiarly inappropriate vehicle for that purpose.

The petition for certiorari should be denied.

Respectfully submitted.

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